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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

---------------------- In the Matter of -------------------)	DOCKET NO. 05-0002
PUBLIC UTILITIES COMMISSION)	
Instituting a Proceeding to Investigate the Issues and Requirements Raised by, and Contained in, Hawaii Revised Statutes Chapter 486H, as Amended)	

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PUBLIC UTILITIES COMMISSION

HAWAII PETROLEUM MARKETERS ASSOCIATION'S

POSITION STATEMENT

EXHIBIT A

and

CERTIFICATE OF SERVICE

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HAWAII PETROLEUM MARKETERS ASSOCIATION'S

<u>POSITION STATEMENT</u>

Hawaii Petroleum Marketers Association ("<u>HPMA</u>"), by and through its attorneys, Cades Schutte LLP, hereby submits the attached Position Statement pursuant to the Regulatory Schedule of the Public Utilities Commission ("<u>PUC</u>") set forth in Order No. 21670 filed March 1, 2005.

HPMA respects and commends ICF Consulting, LLC ("<u>ICF</u>") for its efforts in authoring the Implementation Recommendations for Hawaii Revised Statutes Chapter 486H, Gasoline Price Cap Legislation, dated April 15, 2005 (the "<u>Report</u>"). ICF was restricted by a limited budget and a very short period of time to research and analyze the complex wholesale gasoline industry in Hawaii.

However, HPMA does not agree with all of ICF's conclusions and recommendations in the Report, as further described in the attached Position Statement. At the same time, HPMA recognizes the mandate the Legislature issued to the PUC to implement the gas cap law by September 1, 2005, and should the PUC fail to do so, then the statutory-calculated caps are to go into effect anyway on this date.

Such statutory caps, as ICF notes in the Report, provide for no distinct jobber marketing margins whatsoever and could easily result in the elimination of the entire jobber industry.

HPMA appreciates the difficult and unfamiliar position the PUC has been placed in by now having to regulate prices within Hawaii's wholesale gasoline industry. In the Report, ICF has attempted to provide the PUC with as complete and as accurate of a picture as possible but at the same time ICF acknowledges that its suggested caps will place a substantial risk of irrevocable economic harm on industry participants. ICF identifies the jobbers as being the most likely segment of the industry to suffer such harm.

HPMA has grave concerns as to the dilemma in which the jobber industry finds itself. If the PUC fails to adopt regulations, the jobbers will likely suffer harm because the statutory-calculated price caps ignore the jobber segment altogether and would allow the refiners and suppliers to set prices at the highest wholesale rate possible--leaving no available margin for jobbers. On the other hand, if the PUC adopts regulations based strictly on ICF's recommendations in the Report, it will also result in serious economic harm to the jobbers. Attrition will probably occur based on the unique characteristics of the Hawaii marketplace—characteristics which ICF admittedly did not take into consideration (whether due to lack of time, money, and/or insufficient information). Moreover, the jobber segment is where such attrition is most likely to occur. The irony of this is that jobbers have never been accused of controlling prices or making unjustified profits.

At this stage of the gas cap law's development, common sense dictates that it should be implemented in a way that errs on the side of conservatism to minimize the risk to all concerned, and provide an opportunity to fully understand the law's impacts. To avoid implementing regulations that could severely harm the industry, the PUC should adopt regulations that accomplish at least the following two objectives:

- First, the regulations should enable industry participants to continue providing wholesale product to their customers at historical margins so that the supply of available product is not endangered or disrupted; and
- Second, the regulations should be implemented on a calculate and monitor basis until the PUC and ICF better understand the ramifications of the proposed caps on the unique characteristics and situations of the Hawaii marketplace.

DATED: Honolulu, Hawaii, July 1, 2005.

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HAWAII PETROLEUM MARKETERS ASSOCIATION'S

POSITION STATEMENT

I. Executive Summary and Key Points

- While price controls on gasoline will affect everyone, the gas cap law will cause jobbers and other wholesale marketers the most economic harm.[1]

- As a result of the Information Request process, ICF altered its Task I recommendations (Evaluation of Gas Cap Impacts and Other Issues) and has now warned the PUC to proceed cautiously in implementation of gas caps based on the fact that Hawaii's ethanol blending mandate will radically change the landscape of the petroleum business in Hawaii – from requiring refiners to no longer produce regular gasoline due to ethanol requirements for a special blending stock, to requiring manufacturers and marketers to import ethanol as well as to convert and retrofit their terminals and retail stations to store, blend and distribute ethanol. HPMA strongly supports ICF's latest recommendation "that the Gas Cap implementation be initiated on a 'calculation and monitoring' basis until the ethanol mandate is in place and functional."[2]

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[1] See ICF Report at pp. 7 and 75.
[2] See ICF Response to CA-IR-1.

- In addition to ICF's "calculate and monitoring" without enforcement recommendation, the caps should be implemented, with adjustments to account for ALL of the components that make up Hawaii's wholesale market costs and risks omitted by ICF. This would avoid economic harm and supply shortages, as well as unintended consequences resulting from the ethanol blending mandate.

- With respect to the appropriateness of the baseline and location adjustment recommended by ICF, HPMA reserves comment. Needless to say, however, the security of supply to jobbers will be jeopardized if the baseline and location adjustment are set too low by the PUC. There will be severe market disruptions if this happens. ICF agrees that the price caps are likely to lead to local market disruptions and potentially statewide supply problems. ICF did not evaluate the chances of refineries closing, exports taking precedence over local sales, refinery's changing operations to lower gasoline availability, etc., but agree that all these could occur. DBEDT, in its May 23, 2005 letter to the PUC, has also warned that "[i]f refiners are forced to accept lower margins in the Hawaii market, they may sell their product through un-capped channels of distribution such as exports from the state. If this occurs, Hawaii will face the real risk of product shortages."

- Marketing Margin Factor (ICF Task C)
  - HPMA supports ICF's recommendation for multi-layered marketing margin adjustments for each class of trade (bulk, DTW, branded rack, but not unbranded rack).
  - HPMA recommends that the doubling factor proposed by ICF should be tripled in recognition of the questionable nature of its averaged data, and the need to ease in to such a dramatic and invasive regulatory scheme. ICF's intent was to provide marketers "flexibility" in pricing by using a spread of margins on the mainland. ICF's own work papers show periods where the spread of data ICF used as the basis for its doubling is as much as 7 times[3] from minimum to peak and almost 3 times monthly average to peak. ICF further acknowledges a more appropriate number than its suggested two times may be 2.5.[4] Prudence and caution would dictate an initial multiple of 3, subject to later adjustment based on the PUC's experience to be obtained after implementation.
  - HPMA recommends that the marketing margin be further increased by 10 cpg, allocating 4 cpg to the rack margin and 6 cpg to the DTW margin, to account for many miscellaneous issues identified by ICF as being difficult to quantify and requiring further study, such as temporary competitive allowances (TCAs), land values, rent cap subsidies, the cost of compliance with the price cap law and other laws, the cost impact of divorcement and anti-encroachment laws,

[3] ICF Report, Exhibit 3.15, p. 41.
[4] ICF Response to HPMA-IR-17.

low volumes, etc. These all have potentially large and broad impacts on pricing, and must be accounted for. To assist the PUC in its analysis, HPMA has attached to its position statement a chart summarizing its suggested approvals and modifications to the ICF recommendations.[5]

- HPMA recommends that ICF's recommended Zone Price Adjustments (Task F) use the PUC approved trucking tariffs for common carriers to better account for the actual differentials inherent in delivering varying loads to different locations. Otherwise, in some cases, the cost of operation would not be covered by the allowed margins.[6]

II. **INTRODUCTION:**

A. **HPMA Background**

The Hawaii Petroleum Marketers Association is a nonprofit association, made up of thirteen (13) members, which do business throughout the state of Hawaii. Members include: Aloha Petroleum, Mid Pac Petroleum, Hawaii Petroleum, Maui Oil Company, Senter Petroleum, B&E Petroleum, Fuelman Services, Akana Petroleum, Island Petroleum, Lanai Oil, Garlow Petroleum, Kauai Petroleum, and Maui Petroleum. By ICF's definition and within the petroleum industry they are known as "jobbers." Some are small businesses (as small as four employees), others larger; however, all buy fuel from the refiners

[5] See Exhibit A attached hereto.
[6] Id.

and then deliver it to both small and large commercial accounts, as well as to remotely located "mom and pop" service stations that are not served by the major oil companies. Jobbers in Hawaii supply over 30% of the States' retail gas stations.

Typical customers served by jobbers include farmers, hospitals, construction companies, schools, power plants, police and fire departments, state and federal government, hotels, car rental companies, the postal service, landfills and many more. The list of those who rely solely on jobbers to deliver their fuel is long and their contribution to Hawaii's economy, especially on the neighbor islands and rural Oahu, is large. Businesses served by jobbers collectively employ tens of thousands of workers. If ICF's recommended price caps are implemented, however, a number of jobbers could shut down, or their ability to deliver gasoline could be materially curtailed. That could leave their customers driving long distances and paying more to get the fuel they need to operate and continue in business. Bulk commercial customers will no longer be able to buy at a discount to retail, affecting the costs of hundreds of businesses directly.

Unquestionably, jobbers will be one of the primary groups hurt under Act 242 price controls. As noted by ICF:

> However, that analysis is not the same as actually marketing in a gas cap environment, and also it does not represent the potential issues that small marketers, may have. ICF expects that in some cases attrition of marketers may occur, as well as possibly some service station closures in some areas due to supply cost issues (i.e. cost of supply can't be justified by the marketer).[7]

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[7] ICF Response to HPMA-IR-34.

ICF further acknowledges that their calculation of price caps did "not take into account any attrition that may occur either at the refinery or the wholesale level."[8] Implementation of any type of price caps without understanding or even estimating such serious long-term effects is a risky proposition, and the PUC should take every step to avoid negative, irreversible consequences.

B. Universal Opposition to Gas Price Caps

It is widely accepted that extreme caution is necessary in the implementation of the "Gas Cap" law (HRS §§486H-13-17) as adopted. ICF states, "ICF does not believe HRS Chapter 486H as currently drafted, fully appropriately addresses the Hawaii state legislator's intent to manage the wholesale price of gasoline within the state of Hawaii."[9] ICF goes on to state in response to another IR that, "ICF does not believe gas caps are a 'good' idea."[10] While ICF has tried to alter the law to make it more workable for the PUC to implement, ICF clearly recognizes a strong need for caution given the fact that there are numerous variables that have not been taken into account or have been merely acknowledged without analyzing how they will affect the Hawaii market.

Feridun Fesharaki, Senior Fellow at the East-West Center, notes that "[t]he truth is that our high taxes and government policies that tamper with free-market economics such as so-called caps only lead to higher prices."[11] The Federal Trade Commission echoed this opinion in its study of the prospective Law in 2002. Lowell Kalapa, President of the Tax Foundation of Hawaii observed

[8] ICF Response to HPMA-IR-33(a).
[9] ICF Response to Shell-IR-80.
[10] ICF Response to HPMA-IR-39.
[11] Fesharaki Letter to Editor, The Honolulu Advertiser, April 4, 2005.

that price caps do not work. "What is unfortunate is the people of Hawaii will pay a dear price for this lack of experience and economic illiteracy on the part of public policy makers."[12]

HPMA agrees that the gas cap is bad law, not only because such caps have been shown not to work, but also because their implementation could have negative consequences in the very market place that they are intended to protect. As concluded by the Department of Business, Economic Development & Tourism, in commenting on the ICF report, "[t]herefore, while Act 242 suggests that consumer welfare would be enhanced if gasoline prices reflect competitive market conditions, unless carefully designed, gasoline price caps may create harmful market distortions . . .that may push the market toward more concentration and ultimately, less competitive gas prices."[13]

It is in this context HPMA now offers its position on the impending implementation of the gas cap law, which strives to achieve a reasonable, quantitatively sound, and verifiable mechanism that neither unnecessarily nor unfairly limits Hawaii's competitive market.

III. <u>DISCUSSION</u>:

There is no question that to establish a gas cap, given the numerous variables that must be defined and quantified, is a difficult--if not impossible--task. After studying ICF's report, listening to their presentations, and analyzing their responses to the various IR's, HPMA is of the opinion that ICF lacked the

[12] Tax Foundation of Hawaii, Weekly Commentary, week of May 22, 2005.
[13] DBEDT Letter dated May 23, 2005 to the Public Utilities Commission, based on comments of University of Hawaii economist Jack Suyderhaud.

necessary time and budget to make truly informed conclusions about Hawaii's wholesale gasoline market, relevant price and cost data, or the potential impacts of its recommendations on the market and the industry. As is apparent in many of ICF's comments, the dangers to consumers, industry competition, and ultimately the State of Hawaii are very real. ICF commented that it

> ...does not believe gas caps are a 'good' idea. ICF believes gas caps can be counterproductive to a competitive marketplace[.] ICF believes that the publication of the gas caps and ongoing monitoring and publication of wholesale and retail prices can provide a significant share of the benefits of a rigorous compliance system, and may merit consideration by the Commission prior to a full gas cap implementation.[14]

To establish pricing rules without defining all of the necessary data points that are an integral part of any formula, and without some confidence as to their impact, only defers the problems and creates an immediate damage control scenario upon implementation. Importantly, some of this damage may be irreversible. At the very least, any pricing mechanism that is adopted needs to be adjusted to incorporate additional components, some of which even ICF recognized should have been included in their initial recommendations.

A. Ethanol Blending

In April 2006, the state ethanol mandate (HRS 486J-10) will go into effect, something which ICF's recommendations did not account for and which they now state should be included in the pricing mechanism.[15] "Hawaii is in a position

[14] ICF Response to HPMA-IR-39.
[15] ICF Response to CA-IR-1 & 17.

where the timing of both mandates (the gas cap law and the ethanol) are creating extraordinary and legitimate concerns among marketer and refiners."[16]

ICF recognizes the problems that the ethanol mandate will cause on price caps. Issues such as changing product specifications and the need to change reference prices, increased and varied shipping and distribution costs, etc. ICF also recognizes that price regulation combined with mandated major operational changes makes investment decisions more difficult. ICF warns that it

> has concerns that the marketers, refiners, and consumers in Hawaii may be approaching a confluence of regulatory actions involving both the gas caps and ethanol which will likely create high business and capital investment uncertainty, as well as possible supply concerns. Frankly, the uncertainty around the costs and ability to initially acquire and blend ethanol from outside Hawaii is a greater challenge and issue than the gas caps. If local production was available to meet demand, the Industry investments and costs would be lower and the interaction less of a concern.[17]

ICF further points out that the resultant higher costs will not be incorporated into price caps until the following year, 2007.[18] This leaves at least a year from the April 2006 ethanol mandate, during which Hawaii's petroleum suppliers and marketers will suffer serious inequities under the gas cap law.

Clearly, ICF's responses to the ethanol mandate and small marketer impacts support their recommendation that a "calculation and monitoring" implementation plan should be adopted to take into account ethanol and other unknown factors. It also highlights how the implementation of the gas cap law is a much more sensitive task than initially thought by legislators and, if

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[16] ICF Response to Shell-IR-17(a).
[17] ICF Response to HPMA-IR-38.
[18] ICF Response to HPMA-IR-38(b) and ICF Response to Tesoro-IR-53.

implementation cannot be avoided, then at the very least more leeway for error should be taken into account up front in setting the initial price caps.[19]

HPMA recommends that the PUC conduct a review of the incremental costs of compliance with the ethanol mandate and automatically increase the caps prior to the April 2006 implementation of the mandate.

B. Calculation of Marketing Margins

ICF uses a 'double the mainland's prior year average range' formula to calculate Rack and DTW caps yet recognizes[20] that doubling is not accurate. They quote mainland margin spreads as high as 2.5 times. They also agree that their selected 'visible and competitive markets' regularly price in excess of double the average. ICF recognizes that the doubling formula could lead to price caps in Hawaii that are less than the average in their selected 'visible and competitive markets.'[21]

ICF's calculations of margins start with irrelevant market assumptions and proceed to be modified by gross multiplication. ICF recognizes that other mainland markets could have been utilized as the basis for the caps[22] and may have resulted in substantially different caps.[23]

ICF states that the actual "peak" month margin spread was 2.5, not 2.0, and that it used 2.0 because the last 3 years were 2.3,[24] so why not use 2.3? One has to wonder at the cavalier attitude ICF displayed when suggesting this

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[19] ICF Response to CA-IR-1, 5, 11, 12; ICF Response to Shell-IR-17 & 78; ICF Response to Tesoro-IR-28 & 47.
[20] ICF Response to SHELL-IR-41, HPMA-IR-17.
[21] ICF Response to HPMA-IR-14(c).
[22] ICF Response to Shell-IR-45.
[23] ICF Response to HPMA-IR-39.
[24] ICF Response to HPMA-IR-17

significant multiplier: the difference between 2.0 and 2.3 in ICF's calculation is nearly 3 cents per gallon; a significant number for Hawaii marketers At 3.0 times (easily justified), the difference is over 7 cents. In other areas, ICF spends an inordinate amount of time analyzing costs down to the hundredth of a cent, but it dismisses these differences with a simple doubling.

Leaving aside for a moment their conclusion that the mainland margin should be multiplied by some number to arrive at the Hawaii margin, ICF states no logic for this multiple other than that they expect it to provide "flexibility" for Hawaii marketers. This is perhaps the grossest quantitative assumption in ICF's entire pricing recommendation report. If their intent is to provide "flexibility", and the only mechanism ICF is able to come up with is to multiply the known average mainland margins by some factor, then that factor should be large enough to ensure the intended result. By increasing this factor, the PUC will be able to further determine how best to quantify the admittedly necessary "flexibility."

The foundation upon which ICF's above formula is built is the average data from five states, averaged. When questioned on the selection process, ICF stated that its selections were not based on any relevance to Hawaii markets or costs, but rather on the convenience and availability of data, and because these markets had "a significant volume of DTW business."[25] In fact, ICF chose these states because they contained the cities ICF used for the rack analysis.[26] This is simply not relevant logic on which to base Hawaii margins.

Rather, ICF should have looked for cities and states which have small markets with few suppliers, which more closely replicate the situation in Hawaii. It

[25] ICF Report at p. 40, Section 3.4.2.
[26] ICF Report at page 40.

specifically excluded markets which fit Hawaii better, such as Denver. ICF's approach essentially says that Hawaii pricing should be based on the largest and most active markets with lots of competitors and lots of high turnover volume. This is totally antithetical to the Hawaii environment. ICF's Exhibit 3.14 shows this glaringly by dropping Maine's numbers in with the large markets of Florida, Georgia, Michigan and New York. The variability in that chart is almost *11 cents per gallon*; yet ICF has chosen to fall on the low side of even the mainland margins it selected.

The impact of ICF's chosen database is dramatic on the proposed margins, since the result is going to be doubled (or perhaps tripled per HPMA's recommendation). A search for more "Maine" type markets would likely produce and average closer to Maine's 11 cents, resulting in an ICF margin recommendation of 22 cents (or 33 cents using HPMA's recommended multiplying factor of three). It is critical that the PUC consider having ICF revise this chart to include smaller, higher margin markets, which by that fact alone, are more relevant to Hawaii's market.

ICF further assumes the wholesale marketing costs of Hawaii marketers are the same as those on the mainland[27] and/or ICF failed to analyze the cost structures[28] in each city when analyzing margins. HPMA conducted a quick cost of living comparison for a person making $50,000.00 in Honolulu versus all other 8 cities. In addition HPMA calculated housing in each such city as a percent of Hawaii cost. The results are listed below:

[27] ICF Response to HPMA-IR-10(d).
[28] ICF Response to Tesoro-IR-44(c).

City	Same person living in Honolulu making $50,000, could live with the following amount in the corresponding city	Housing (as a percent of Hawaii cost)
Albany	$28,900 (42% less)	Not available
Atlanta	$32,500 (35% less)	40%
Dallas	$30,830 (38% less)	44%
Detroit	$26,400 (47% less)	46%
Phoenix	$29,950 (40% less)	38%
Portland	$35,080 (30% less)	Not available
Seattle	$39,540 (21% less)	61%
Tampa	$28,300 (43% less)	55%

This is not to say that there is a direct correlation between costs and margins but the above data suggests that higher costs put pressure on margins to support the cost of living and the cost of doing business.

Based on Exhibit 3.15 of the ICF Report at page 41, the historical real world DTW margin variability was as high as 7 times (minimum to peak). Since there is no exact science behind ICF's number of 2.0, and since the maximum over the period they studied was 2.5, HPMA recommends using a multiple of 3.0 instead of 2.0 to better reflect the historical real world DTW margin spread and to provide the necessary flexibility to avoid unnecessary harm.

The additional time afforded by a 'calculate and monitor' period and prior to enforcement will further ensure that the PUC's reporting system (software and database development, hardware acquisition, staffing, etc.) for industry participants will be properly developed and implemented.

C. Additional Marketing Margin Adjustment

There are other cost components that must be incorporated into the calculation of Gas Cap margins. If not, a jobber will be unfairly competitively limited and potentially irreparably damaged, possibly to the point that the jobber can no longer sustain its operations.

ICF states, "[t]here are no calculations done to show that any jobber can exist on these [ICF recommended] margins."[29] How can a margin be set with no idea as to whether that margin will support existing businesses or not? This comment is closely related to ICF's statement in the Report that "attrition will have to be understood," and confirms their conclusion that "the gas caps or subsequent adjustments does not take into account any attrition that may occur either at the refinery or the wholesale level."[30] In other words, jobbers may go out of business before any adjustment can be made to the margin calculations. It would be irresponsible to implement regulations on such a haphazard basis and lacking such information.

1. Hawaii's Higher Costs

Initially ICF "elected . . . to recommend margin caps based on ... comparison to Mainland margins."[31] ICF's approach completely ignores Hawaii's higher costs in their analysis.

The myriad of costs which are higher in Hawaii are well known. Except for portion of the three zone adjustments, ICF took none of these into account.[32] For instance, Hawaii is a smaller market, leading to higher costs per gallon. That means that fixed costs are spread over fewer gallons making it a factor that must be accounted for. Such fixed costs on the mainland are inherently lower per gallon due to their larger volumes. ICF did not take this fact into account. Hawaii

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[29] ICF Response to HPMA-IR-31(b).
[30] ICF Response to HPMA-IR-33(a).
[31] Id.
[32] ICF Response to HPMA-IR-10(d).

is a stagnant market with virtually no growth prospects. ICF did not consider this fact. Hawaii is not a gasoline market where marketers have the ability to switch suppliers daily. ICF did not factor this into its analysis. Hawaii's unique cost structure is neither a myth nor an intangible. To try to bypass the analysis of cost factors and risk factors by assuming that mainland marketer margins should be sufficient for Hawaii marketers is a gross oversimplification. This is a case where the "devil is in the details," and broad assumptions and averages-of-averages over long periods of time are not going to do an adequate job of "simulating" Hawaii market conditions and structure.

2. Exclusion of Overhead, Investment, Working Capital and Risk.

ICF has repeatedly acknowledged that overhead, investment, working capital and risk elements were not considered in its pricing formula recommendations. It does NOT argue that these are irrelevant costs which are included in mainland margins. Rather, ICF concerned itself only with direct costs (i.e., cost of product acquisition and delivery).

In fact, these are very significant costs which vary greatly among Hawaii's suppliers and marketers, and cannot simply be ignored or expected to be absorbed by other products or operations. To standardize them is to imply that all suppliers and marketers should operate and be financed on the same basis. The element of risk also cannot be ignored. It is basic economics that a business facing higher risk needs to get higher margins. The same is true of businesses with low or no growth prospects. Hawaii is such a market and margins are related to these factors.

3. Compliance Costs and Other Impacts.

ICF has not included any mechanism for marketers to recoup the costs of compliance with this price-cap system.[33] Further, the FTC has estimated that the impact cost of divorcement and anti-encroachment laws is roughly 2.6 cpg.[34]

4. Temporary Competitive Allowances (TCA).

Several questions relating to Temporary Competitive Allowances (TCAs) offered on mainland markets were raised. ICF response was that although they agreed that TCA's occur, they were not included in the gas cap mechanism. ICF noted that

> [t]emporary Competitive Allowances (TCA), which are awarded by wholesalers to jobbers on purchases, were not taken into account in computing the rack margins. ICF concurs that these occur, but there is no reliable mechanism for estimating the impact over time to establish a dependable chain of information, so they were not included.[35]

Such allowances result in lower costs and consequently higher than reported margins for mainland marketers. ICF used reported prices and costs in their data, which never reflect TCA's.

5. ICF Adjustment Recommendations.

ICF agrees that the mainland markets they selected for comparison purposes have significant structural differences from Hawaii. For example, they are significantly larger markets (with an average of 6,000 gas stations per state versus Hawaii's 366) and are not heavily regulated with such restraints as rent-caps and/or subsidies. "Based on the sessions in Hawaii, ICF understands that

[33] ICF Response to Shell-IR-66
[34] Testimony of Jerry Ellig of the FTC before Hawaii Legislature, 2003.
[35] ICF Response to HPMA-IR-15.

the impact of lease rent caps may represent a fundamental cost that mainland markets may not experience. An adjustment to reflect this may be worthy of consideration."[36] Additionally, consideration must be given to the divorcement and anti-encroachment laws and ethanol mandates that exist in Hawaii. Lastly, they agree that their analysis ignores factors in those selected markets such as Temporary Competitive Allowances[37] and Cash Discounts[38] that would add to the margins they calculated. In summary, ICF stated it "believes that Marketing margins may merit review to determine if fundamental Hawaii differences from the mainland (primarily land/rent caps) should be reflected."[39] This review should ideally occur prior to enforcement, not after.

HPMA recommends that the marketing margin factor be increased by 10 cpg to account for the miscellaneous issues identified by ICF and HPMA as being difficult to quantify and requiring further study, such as temporary competitive allowances, land values, rent cap subsidies, the cost of compliance with the price cap law and other laws, the cost impact of divorcement and anti-encroachment laws, low volumes, etc. The 10 cpg should be allocated on a 40/60 split between Rack (4 cpg adjustment) and DTW (6 cpg adjustment), respectively, which are based on the margins presented by ICF's initial recommendations of 6.7 cpg and 8.3 cpg for Rack and DTW, respectively.

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[36] ICF Response to Tesoro-IR-43(c).
[37] ICF Response to Shell-IR-40; HPMA-IR-9 & 13.
[38] ICF Response to Shell-IR-39.
[39] ICF Response to HPMA-IR-39.

D. Premium and Midgrade Adjustments

HPMA recommends that ICF's Premium and Midgrade adjustment factors be increased by 4 cpg for Premium DTW and rack and by 2 cpg for Midgrade DTW and rack. This increase will better reflect the actual historical margins in Hawaii and is necessary in order to avoid economic harm to Hawaii's market participants.[40]

E. Zone Price Adjustments

ICF notes that it "averaged these data to arrive at 'typical' barge, terminalling, and trucking costs for each zone."[41] On the surface this appears to be a nice idea in a conceptual world, but in the real world there are no "typical" barges, terminals or trucks -- only real ones. Some barges are big and some are small. Some trucks have 9,000 gallon compartments and others have 500 gallon compartments. Some barges and trucks make one stop, others make several.

ICF's use of averages gives a huge advantage to the big oil companies with high volume requirements that can use the larger barges, terminals and trucks and command low barging, terminalling and transportation costs. A smaller shipper or jobber will find itself at a significant economic disadvantage to the point of ceding the neighbor island business to the big oil companies. Or, worse yet, abandoning smaller accounts on the neighbor islands that the big oil companies will not serve (which is why they are jobber accounts to begin with). ICF recognizes the potential problems this will cause, such as negatively

[40] See ICF Report Exhibit 4.12.
[41] ICF Report at p. 64.

impacting marketers in remote locations,[42] and disadvantages between full and partially-full truck deliveries.[43] To adequately account for higher barging and trucking costs imposed on the smaller shipper, the PUC should create a cap based on the published tariff rates for such transporters or allow for an additional premium to reflect actual available rates, as opposed to the rates that a large oil company is able to negotiate.

ICF also uses a "rule-of-thumb" to calculate trucking costs that it says are 2.4 to 3.2 cpg on the mainland. ICF then proposes to use 2.7 cpg for Oahu,[44] surprisingly concluding that Oahu costs are similar to the mainland (especially surprisingly given that ICF admits it failed to study Hawaii costs). ICF then "used the formula '80% of the low and 20% of the high' to estimate average zone cost'[45] to estimate the actual trucking costs over the Oahu costs for all sales within a zone. The outcome is to recommend that the DTW price cap for a remote station assumes a trucking cost well below actual costs and well below the PUC's own approved trucking costs.[46]

HPMA recommends that the PUC-approved trucking tariffs for common carriers be used in the zone adjustment to better take into account the actual cost differentials inherent in delivering to locations at varying distances and with various load sizes, from the load rack.[47] Further, since there are no published common carrier barging tariffs for petroleum products, an appropriate small barge premium should be considered as reflected in Exhibit A attached hereto.

42 ICF Response to Shell-IR-78(b).
43 ICF Response to Tesoro-IR-49.
44 ICF Response to HPMA-IR-29(b).
45 ICF Response to Shell-IR-60
46 See Haw. Admin. Rules, Title 6, Chapter 63, Motor Carrier Tariffs and Schedules.
47 E.g., the approved tariffs of the Western Motor Tariff Bureau, Inc.

F. Calculate and Monitor

The PUC should adopt ICF's latest recommendation "that the Gas Cap implementation be initiated on a "calculation and monitoring" basis until the Ethanol mandate is in place and functional."[48] Further, it will allow additional time to continue with analysis of the multiple variables that need to be identified and quantified to ensure that the implementation of the gas caps does not cause irreparable harm to Hawaii's marketers and economy. Note that, "ICF believes that it is reasonable and prudent to consider the impact of this issue [marketers and/or suppliers ceasing operations in remote areas] prior to implementation."[49] In addition, HPMA strongly suggests the PUC implement this law as loosely as possible. In other words, by making sure the caps provide for plenty of flexibility for all market participants to continue operating under historical margins, the PUC will accomplish several prudent objectives:

1. There will be as little economic harm as possible;
2. There will be no supply interruptions;
3. The process can be properly designed, installed and refined;
4. Over time, the elements of pricing can be tightened to achieve the desired result, rather than loosened in a panic when unintended consequences occur.

The mechanisms for doing this are available in the law and in the structure proposed by ICF. In fact, ICF recognizes the need for truing up all of its recommendations after implementation. HPMA suggests the PUC might want to

[48] ICF Response to CA-IR-1.
[49] ICF Response to Shell-IR-78(b).

adjust at an appropriate pace after September 2005, rather than be besieged with decisions to avoid or reverse serious negative effects caused by trying to implement too restrictively on September 1st. In other words, a calculate and monitor approach using flexible caps:

- Is within the law's requirements;
- Uses ICF's general recommendations;
- Allows proper process implementation;
- Allows consideration of ethanol; and
- Allows further study of impacts and data sources.

IV. SUMMARY:

In summary, HPMA recommends that the Gas Cap mechanism as proposed by ICF be (i) amended to include those pricing components listed below that are integral to the operations of Hawaii's marketers, and (ii) implemented on a "calculate and monitor" basis. The additional pricing components HPMA recommends include:

1. Baseline – adopt a baseline and location adjustments that enable the jobber suppliers to continue supplying product;
2. Ethanol Blending – adopt an impact cost of 10 cpg;
3. Marketing Margins – Use a multiple of "3" instead of "2";
4. Additional marketing margin adjustments – Increase this margin by 10 cpg to account for land values, rent cap, TCA's, etc;
5. Zone price adjustments – For trucking and barging costs, adopt the PUC-approved tariffs; and

6. Calculate and monitor until a better understanding of the law is known.

These recommendations are compared with the ICF recommendations in the chart attached hereto as Exhibit A.

WHEREFORE, HPMA requests that the Commission modify ICF's quantitative price formula recommendations as set forth above and consider implementing the law under a 'calculate and monitor' basis (as opposed to enforcement) to test the validity and adjust the applicability of the various "omissions," "estimates," and "averages," to allow for further impact analysis and quantification of the Hawaii market to ensure that if a gas cap law is to be implemented that it be fair to all concerned and not unreasonably burden one class of business over others.

Respectfully submitted,

Hawaii Petroleum Marketers Association

By:____________________
Robert Fung
Its President

Attachment: Exhibit A

Gasoline Price Caps Under HRS CH 486H

Comparison of HRS 486H-13 Specified Factors; ICF's Recommendations; and HPMA's Recommendations

Component	HRS Specified	ICF Original Recommended		ICF Modified Recommendations	HPMA Recommended	
Baseline Price Regular Unleaded HRS 486-13(c)	LA, NY Harbor & USGC adjusted weekly	Singapore & Caribbean adjusted weekly	ICF recommended sources averaged 8.5 cpg below HRS specified from 99'04'	None	We believe the PUC needs to makes sure that the refiners are capable of providing product to ensure adequate supply.	
Location Adjustment Factor HRS 486-13(d)	4.0 cpg	Market based freight costs from Singapore and Caribbean to Hawaii, adjusted weekly	ICF Location adjustment costs averaged 7.5 cpg above HRS specified from 99'-04'	Add .35 cpg for inventory cost and adjustments for potential increases in import duties and Panama Canal fees etc. when they change	We believe the PUC needs to makes sure that the refiners are capable of providing product to ensure adequate supply.	
Marketing Margin Regular Unleaded HRS 486-13(e)	18.0 cpg	DTW:	15.0 cpg	ICF recommends modification to marketing margins based on land values and rent caps. Eliminating bulk and unbranded class of trade. Other misc corrections	DTW:	32.5 cpg
		Rack-Branded:	6.7 cpg		Rack-Branded:	14.05 cpg
		Rack-Unbranded:	9.7 cpg		Rack-Unbranded:	eliminate
		Bulk:	1.0 cpg		Bulk:	1.0 cpg
Mid Grade Adjustment HRS 486-13(f)	5.0 cpg	DTW:	6.5 cpg	None	DTW:	8.5 cpg
		Rack-Branded:	4.2 cpg		Rack-Branded:	6.2 cpg
		Rack-Unbranded:	4.2 cpg		Rack-Unbranded:	n/a
		Bulk:	2.0 cpg		Bulk:	2.0 cpg
Premium Adjustment HRS 486-13(g)	9.0 cpg	DTW:	10.0 cpg	None	DTW:	14.0 cpg
		Rack-Branded:	9.0 cpg		Rack-Branded:	13.0 cpg
		Rack-Unbranded:	9.0 cpg		Rack-Unbranded:	n/a
		Bulk:	6.0 cpg		Bulk:	6.0 cpg
Zone Adjustments HRS 486-13(h),(i) Zone 1 Oahu	Not specified	DTW:	2.2 cpg		DTW:	2.2 cpg
		Rack-Branded:	2.2 cpg		Rack-Branded:	2.2 cpg
		Rack-Unbranded:	2.2 cpg		Rack-Unbranded:	n/a
		Bulk:	2.2 cpg		Bulk:	2.2 cpg
Zone 2 Kauai	Not specified	DTW:	11.4 cpg		DTW:	9.9+PUC tariff rate
		Rack-Branded:	9.9 cpg		Rack-Branded:	9.9 cpg+small barge premium
		Rack-Unbranded:	9.9 cpg		Rack-Unbranded:	n/a
		Bulk:	9.9 cpg		Bulk:	9.9 cpg+small barge premium
Zone 3 Maui	Not specified	DTW:	9.8 cpg		DTW:	9.7 cpg+PUC tariff rate
		Rack-Branded:	9.7 cpg		Rack-Branded:	9.7 cpg + small barge premium
		Rack-Unbranded:	9.7 cpg		Rack-Unbranded:	n/a
		Bulk:	9.7 cpg		Bulk:	9.7 cpg + small barge premium
Zone 4 Hana	Not specified	DTW:	28.4 cpg		DTW:	28.4 cpg
		Rack-Branded:	n/a		Rack-Branded:	n/a
		Rack-Unbranded:	n/a		Rack-Unbranded:	n/a
		Bulk:	n/a		Bulk:	n/a
Zone 5 Molokai	Not specified	DTW:	31.2 cpg		DTW:	31.2 cpg
		Rack-Branded:	n/a		Rack-Branded:	n/a
		Rack-Unbranded:	n/a		Rack-Unbranded:	n/a
		Bulk:	n/a		Bulk:	n/a
Zone 6 Lanai	Not specified	DTW:	40.3 cpg		DTW:	40.3 cpg
		Rack-Branded:	n/a		Rack-Branded:	n/a
		Rack-Unbranded:	n/a		Rack-Unbranded:	n/a
		Bulk:	n/a		Bulk:	n/a
Zone 7 Hilo	Not specified	DTW:	13.2 cpg		DTW:	11.1 cpg+PUC tariff rate
		Rack-Branded:	11.1 cpg		Rack-Branded:	11.1 cpg+small barge premium
		Rack-Unbranded:	11.1 cpg		Rack-Unbranded:	n/a
		Bulk:	11.1 cpg		Bulk:	11.1 cpg+small barge premium
Zone 8 Kona	Not specified	DTW:	16.0 cpg		DTW:	11.4 cpg+PUC tariff rate
		Rack-Branded:	11.4 cpg		Rack-Branded:	11.4 cpg+small barge premium
		Rack-Unbranded:	11.4 cpg		Rack-Unbranded:	n/a
		Bulk:	11.4 cpg		Bulk:	11.4 cpg+small barge premium

EXHBIT A

CERTIFICATE OF SERVICE

I hereby certify that on July 1, 2005, I served copies of the foregoing, together with this Certificate of Service, either by United States mail, postage prepaid, or by hand-delivery to the following:

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